RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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May 21, 1986 **LETTER 939**

May 9 Dow 1789.43; PTI 2268; A-D Ratio -5.83
May 16 Dow 1759.67; PTI 2252; A-D Ratio -6.61

THE MARKET: In the last Letter I made a few statements that I want to repeat again. First, this is still a primary bull market. And I'll state again that primary bull markets don't end on shocking news events, and I don't care whether the news event is a farm depression or nuclear meltdown or a presidential heart attack. Big bull markets end only one way--in exhaustion (I define exhaustion as the time when the last buyer has spent his last buck).

Next, I stated that the key to the near-term market trend was what the D-J Industrial and Transportation Averages did in relation to their April 7 low points. Those low points are respectively 1735.51 for Industrials and 778.83 for Transports (see page 1 chart). I said that as long as ONE OR BOTH Averages held ABOVE those lows I would consider the secondary trend of the stock market to be bullish (we're not even questioning the bullishness of the primary trend).

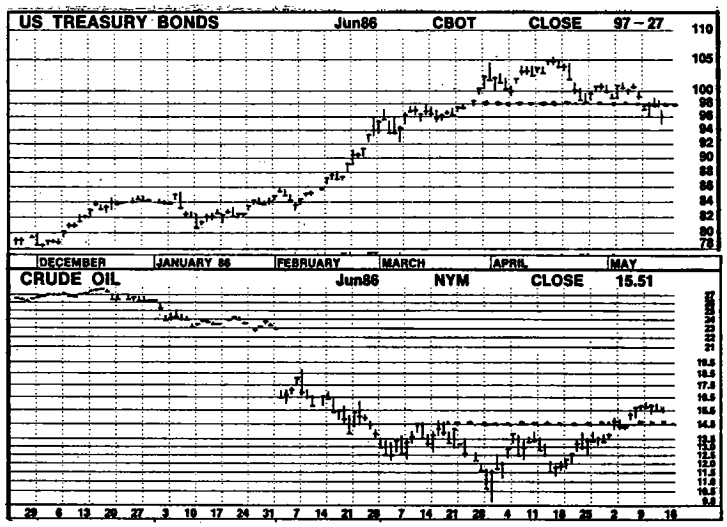
So far, the two Averages have declined and approached the April 7 lows, but NEITHER Average has (as this is written) violated the aforementioned lows. Thus, the minor trend of the market has been bearish since late-March, but at no time has either the secondary or the primary trend of this market been anything but bullish. And that probably flies in the face of most of what you have read and heard.

Turning to the page 2 chart of the Dow, the PTI and the A-D ratio, note that the PTI, having hit a record 2272 in April, is now rolling over and turning down. Nevertheless, the PTI is still roughly 75 points above its 89-day moving average, and as long as the PTI holds ABOVE the MA, I classify it as in the (long-term) bullish mode. The PTI, like almost every average and indicator, rallied too far above its moving average, and therefore (as I have been warning would happen), the various indices are now testing those moving averages. The A-D ratio, having signaled the END of the "buying stampede" as early as April 4 (see Letter 936), is now coming down in earnest.

Therefore, uncertainty, backing-and-filling and declining tendencies are the healthiest action we can have in the market now. And as long as the two Averages (Industrials and Transports) hold above their April 7 lows of 1735.51 and 778.83 respectively, the market will be in a bullish trend from the standpoint of both the secondary and primary trends. Furthermore, it is significant that the market has held together as well as it has in the face of the currently declining bond market.

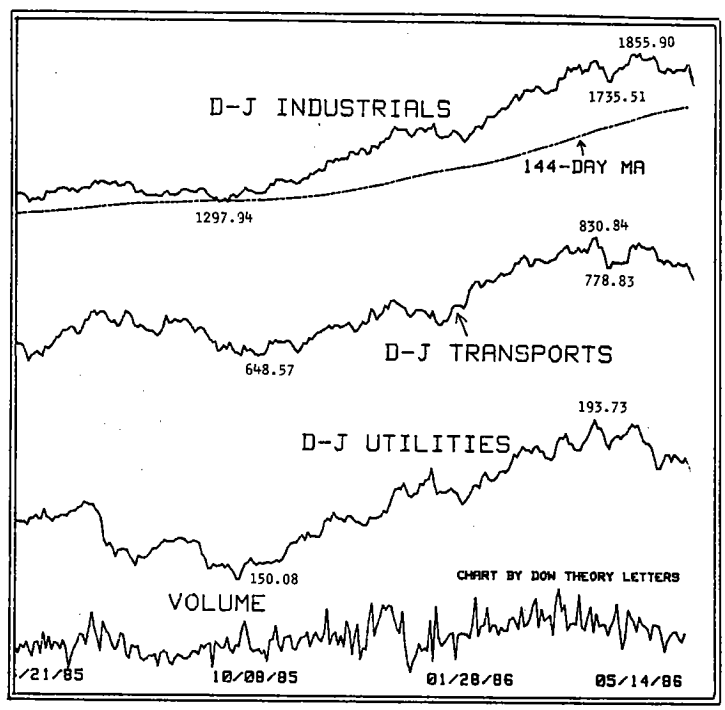
Incidentally, another phenomenon is worth noting here. Over the last 10 trading days the odd-lot shorts (generally the wrongest group in the market) have rocketed their selling to an average of 72,000 shares sold short per day! Since a "normal" day odd-lot shorts run around 1 to 3 thousand, the recent trend is astounding. It suggests that the odd-lot public is preparing for a market collapse. As I stated, the odd-lot shorts tend to be very wrong (and yes, I know that a certain percentage of the odd-lot shorting represents arbitrage, but the recent odd-lot short totals are still staggering).

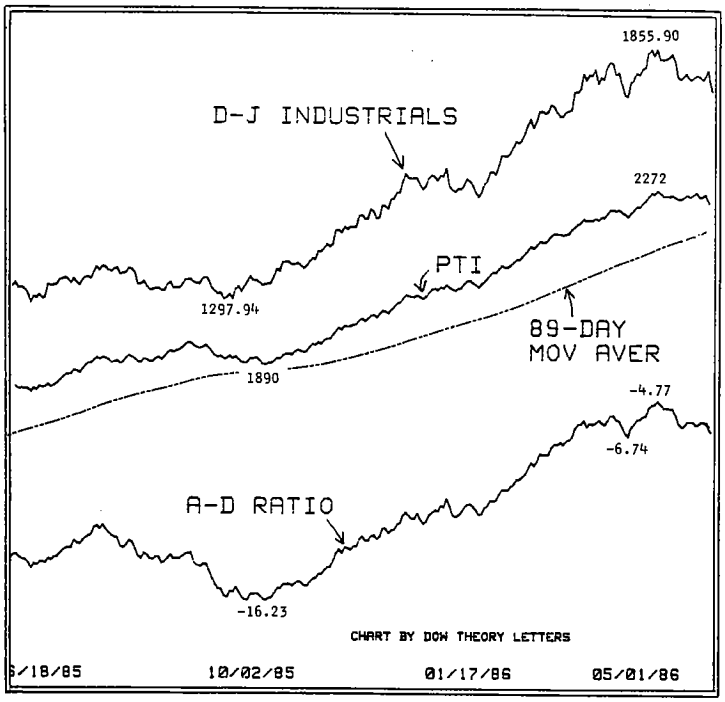
SIGNIFICANT TRENDS: I want to follow up on two items that I discussed in the last Letter. These are crude oil and bonds. I think these charts (courtesy of Investor's Daily) say it all. As noted last time, the crude oil (futures) contract has formed a head-and-shoulders bottom, while simultaneously the T-bond contract has traced out a H & S top.



Since the last Letter, the crude oil has broken out above the critical 15 level (basis June), and the T-bond contract has violated its critical (again basis June) level of 98. So we now have oil in a bullish trend and bonds in a bearish trend.

My own instinct (for what it's worth) is that neither of these trends are going to go very far. Oil is basically being manipulated by the Saudis as they fight to hold their leadership of OPEC in place, and the bonds are most probably a reflection of the US's continuing balance-of-payments deficit. The "Gang of Five" will undoubtedly fight any persistent trend to lower bond prices (and accompanying higher interest rates), so my best educated guess is that neither of these trends is going to go too far.





DOW STOCKS: Over the last few years I have been saying, "Buy the strongest of the 30 Dow Industrial stocks." If this is a bull market, then, by definition, the Dow must rise. Given that thesis, it is totally logical that we buy the strongest Dow stocks for purposes of participating in the bull market.

And that policy has worked well. But at this time, only 11 of the 30 Dow Industrials are showing positive relative strength, and three of these, Allied Signal, Amer. Can and Amer. Express, are showing ebbing positive relative strength. The 11 still in positive relative strength trends are: Allied Signal, American Can, Amer. Express, DuPont, McDonalds, Merck, Owens-Illinois, Philip Morris, Union Carbide, Westinghouse and Woolworth.

Interesting observations on Dow stocks: GM, Goodyear, Bethlehem, US Steel are all hitting new lows in rel. strength and should be avoided. New highs or near-new highs in rel. strength are seen in MCD, MRK, OI, WX, Z. The three workhorses have been MRK, MCD and Z. Woolworth (Z) (often recommended here) has been a surprise winner. Lowly, ancient Woolworth has been a winner for two years (see Mansfield weekly chart), proving that you don't make money in the market on glamour, you make it on market performance. Who would have thought that you would have done better since 1984 with Woolworth than IBM? Yet IBM's rel. strength line turned down in early-1985, while Woolworth's rel. strength line continued to rise to new highs.

INVESTMENT POSITION: The bull is in the box. I guess the majority of "experts" now feel that this market is in a secondary downturn, but I go by the tenets of Dow Theory, and as long as one or both of the D-J Averages hold above their April 7 lows, Dow's Theory says that the secondary trend remains bullish.

I have not suggested anything but a "buy 'em and hold 'em" stance in this bull market, and I still feel that is the path to making real money. Anyone who has adhered to this formula must have substantial profits by now. The bull market is not over, so let's stay with our stocks and bonds. Frenzied speculation on the part of the public and extreme overvaluation will ultimately kill this bull market. I don't see either of those phenomena yet. I know from experience that it's very hard to sit through a big bull market; one is tempted over and over with each reaction to sell. But the big money is made via PATIENCE.

NO BULL: Well, it finally happened. With all my concentration on the new Macintosh word processor and its laser printer, I left the darn bull out of the box in the last Letter. I hope this didn't cause panic or too much angst among my subscribers. I still don't know how I did this and how everyone else in the office missed it. So all I can say is "I'm sorry; from now on I'll watch that bull like a hawk!"

RUSSELL'S BIG PICTURE: As veteran readers know, I work two ways. I watch what the market is doing and saying, and I read everything in sight. Then I try to bring the two together and make sense out of the whole picture. In this process I always work on the the thesis that the market knows a thousand times more than I do. Consequently, I always defer to the market. In other words, my theories and perceptions MUST fit into the context of market action.

Here are a few ideas, all contained within a major new concept, that I have been stewing over. The first is that I feel the US is now pulling ahead of Russia in many critical areas. I feel that the Chernobyl nuclear disaster was almost symbolic of the beginning of a major reversal in the world's perception of Communism. Suddenly, in one fell swoop, Russia and her new public relations-minded leader (Gorbachev), are shown to be just the old paranoid Russia: inefficient, pathetically secretive, callous toward human life, and backward compared with the US as far as scientific capabilties are concerned. From a propaganda standpoint, the Chernobyl meltdown was a disaster (and watch what happens when the death toll starts mounting!).

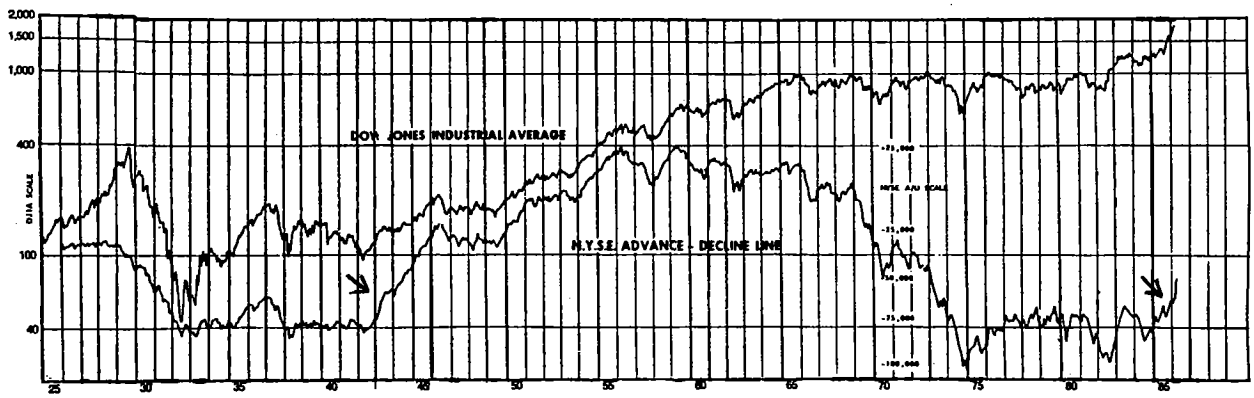
I am now going to refer to this long-term chart, page 3 (courtesy of Smith, Barney). Here we see 60 years of history in both the Dow Industrials and the advance-decline line. The A-D line is a proxy for ALL the stocks on the NYSE. As you study this fascinating chart, note that there was a huge smash in the A-D line during the period of 1928 to 1932. Then from 1932 to 1942 the A-D moved sideways, really in an extended trading range.

In the fateful year 1942 the A-D line turned up, and in 1943 the A-D broke out above the entire 11-year trading range. What followed was the greatest breadth explosion in stock market history. The A-D continued to climb (with a major interruption during the 1946-49 bear market) until 1956. This was an incredible 13-year rise following the 1943 breakout. During this extraordinary period World War II ended, the US changed to a peacetime economy, inflation remained low, and Americans stocked up on all the items they had missed during the War.

Now turn to more recent history starting with the year 1974. Following the bear market year 1974, the A-D line again moved sideways in a trading range. The trading range lasted for nine years. In 1983 the A-D (with great force) broke out above its nine-year trading range. By late 1985 the A-D had surged well above all readings going back to 1973. Wall Street had seen nothing like it since the period of the early 1940s.

What could be behind the most recent (1982-86) A-D explosion, and what could it mean for the markets of the future? Here are some of my thoughts. As we look at the US today, we see "smokestack America" in shambles, and by smokestack, of course, I mean heavy industry such as steel, machine tools, mining, etc. Then we look at agriculture, and we see a depression. Next we look at oil and the energy business, and again we see something that can only be labeled depression or near-depression.

But here's the interesting part. With all this economic disaster, the stock market is still in a primary bull trend, and the economy is still basically holding together. My belief (and I've written about this many times) is that this economy is going to continue to hold together--but the nation, nevertheless, is also moving into very difficult times. I believe they will be disinflationary or even deflationary times, and I think we are going to see drastic changes in the whole American business scene. Let me put it this way: the good old days, the easy ways, the inflation-aided profits, the pile-up-inventory-and-let-the-profits-run days, they're over. From now on, the US is going to have to get "lean and mean" in order to



survive. And I think we're going to do it. But it's going to take lots of time.

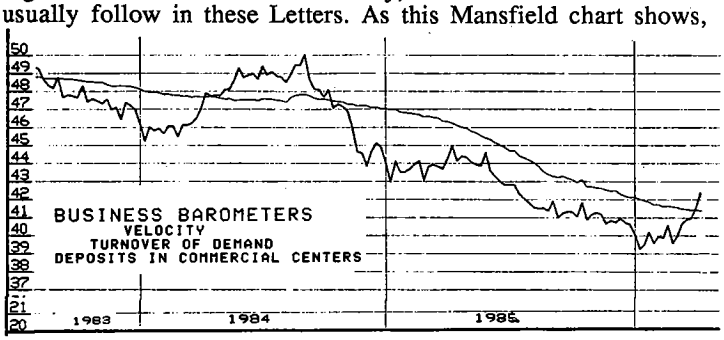
I believe we're going to see an extended period wherein America goes back to competing, and where we will very probably see men looking for jobs instead of raises. We're going to see corporations showing real profits, not inflation profits. We're going to see the dawn of a new American work ethic. I think we're going to see all that coming. But the trick will be to get through this very difficult period while avoiding depression.

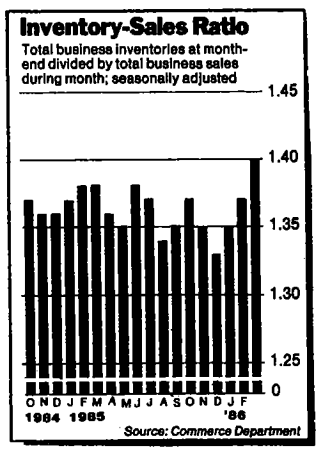
You know, one of the fascinating things about Wall Street today is the prevalence of the "another 1929 is coming" talk. Everywhere I turn I read about some guru who is predicting another 1929 crash and subsequent depression "just as soon as this overblown bull market is over." The fact is that if we are fated to experience another 1929-type crash and depression, it will be the best advertised economic disaster in US history!

Could there be a fooler here? I've been mulling over this for a long time, and I guess I've never had the nerve to write about it. But in my opinion the big fooler could be a prolonged period (following the 1983 A-D breakout) that would resemble the extended era following the 1943 A-D breakout. This new period would include a major rise in the stock market which could last over a decade. The period would include much painful adjustment, but basically it would be a HEALTHY period for the US. It would, so to speak, put us back in business. It would be as if America had returned to reality, come back to its senses. Featured in this period would be (1) little or no inflation, (2) a return to tough international business competition, (3) a return to the work ethic, (4) serious debt reduction on every level. In other words, a return to old-fashioned solvency.

Anyway, it's an interesting concept, and it very clearly flies in the face of the conventional wisdom. Furthermore, and this is important, it fits in with what I observe on this long-term chart of the A-D line. Remember, Wall Street has a habit of doing what no one is prepared for and what no one is willing to believe. Expect the unexpected is the motto of those who survive in this business. I don't think many expect a scenario such as the one I have outlined above.

GOOD & BAD: Here are two charts that should make us ponder. The velocity of checking account turnovers at the big banks is usually a good indicator of business activity, and it is an indicator that I usually follow in these Letters. As this Mansfield chart shows,




Inventory-Sales Ratio
Total business inventories at month-end divided by total business sales during month; seasonally adjusted
1.45
1.40
1.35
1.30
1.25
0
O N D J F M A M J J A S O N D J F
1984 1985 '86
Source: Commerce Department

velocity has finally broken out on the upside after its long 1984-86 slide. Normally, this should be a signal for rising business activity.

But on the negative side is this chart of the inventory-sales ratio, and it shows that inventories in the US are now running on the high side compared with sales. When this occurs, there is usually a period wherein manufacturers and stores cut back while they try to work off their top-heavy inventories.

So what's the answer? It could be that the rise in velocity is coming mainly from the service and finance areas of the economy while the poor inventory-sales ratio reflects what is happening at the manufacturing end of the economy. At any rate, the two charts reflect a schizophrenic business picture, and that may fit right in with what the stock market is reflecting now.

DOW'S THEORY: I have from the beginning called this service Dow Theory Letters. The reason for this is obvious--I follow the precepts of Dow Theory. The Theory in its simplest form entails following the action of the Dow Jones Averages closely, but it also entails identification of market phases, volume implications, investors' sentiment, values, yields, and a dozen other items.

Over the years I have added a great many studies and gimmicks to my market interpretations, and I have discussed quite a few of them in the Letters. The various indicators (the good ones) have a habit of being useful for a while; then when they gather too large a following they seem to fade away, only to return to usefulness maybe years or even decades later.

I developed my Primary Trend Index because I felt that there would be a need for an indicator that was not in general use--an indicator that could NOT be followed by the public. I wanted an indicator that would be based not on some subjective opinion but on the ACTION of the market itself. Therefore, I based my PTI on eight different action-of-the-market averages and indices. Over the 15 years that I have used the PTI, I have found it to be at various times useful, very useful--and on a few occasions , a lifesaver.

I note now that there is a huge proliferation of market services, market theories and market writers, the latter often known loosely as investment advisors. As a matter of fact, if you want an interesting peek into the new world of "gurus of the late-1980s," I strongly suggest that you study any current issue of the new Investor's Daily. This daily is geared toward commodity traders, stock market technicians and performance-minded investors. And actually, I think this is a very good market newspaper. It fills a void that the conservative Wall Street Journal has long ignored, and that void is the market void.

The fact is that the Journal has always disliked or been skeptical of technical analysis. The Journal has finally been forced (in my opinion) to expand its last-page market section. But if the Journal had been less hide-bound and more aware of what's going on in the world of investing there would have been no reason for Investor's Daily to exist. Happily for Investor's Daily, the fuddy-duddy Journal never did (and still doesn't) see the need for individual commodity charts, foreign market charts, relative strength ratings, group ratings, and dozens of other items that are invaluable for intelligent investing. Significantly, the Journal does not accept investment advisory advertising, and as a result, Investor's Daily is now filling up with advisory advertising.

But back to my story. A glance at Investor's Daily will present you with a mass of advisory advertising replete with all kinds of claims, boasts and promises. It's almost comical to view the fervor and energy with which the various advisories compete. And I must confess that I'm a bit skeptical about probably 80% of the claims that appear in this advertising.

My bet (and I've seen this happen many times) is that the next bear market will, among other things, serve to clean the pages of Investor's Daily. Four out of five of the new advisory letters (sadly) will go "the way of all flesh" or in this case, the way of all paper. It's a sad commentary on this business, but it happens--over and over again.

I have my own secret for staying alive in this business, and the secret has worked for me ever since the 1950s. That secret is called the Dow Theory, it's as simple as that. Over and over again I've seen the Averages tell the story when that story seemed to go against everything else I've read and heard. And my guess is that Dow's Theory will outlast me and just about all of today's market writers, money managers and fund managers.

Back in 1936 a genius named Robert Rhea wrote the following: "He who has absorbed Dow's Theory needs no advice; moreover, he becomes insulated against the hysteria that causes people to over-trade in the final stages of a bull market, while becoming immune to the pessimism which prevents others from buying stocks near the end of bear periods." No truer words were ever written.

NOTES & QUOTES: The African nations have the highest birth rates in the world (for example, half the population of Ghana is under 15 years of age!). Put it this way: the last thing in the world Africa needs now is more children (most of the kids in Africa are currently on a subsistence diet). Thus, this news clip goes into our "This Week's Most Depressing News Story" Dept.

Reuters

NAIROBI, Kenya — A nine-year-old Kenyan girl gave birth to a baby girl at Nairobi's Kenyatta Hospital recently, the Sunday Nation newspaper reported.

The paper also said Kenyatta Hospital doctors had complained about the increasing number of child mothers, aged between 11 and 13 years.

Kenya's birth rate of 4.1 per cent is among the world's highest and the government has embarked on a vigorous birth control program.

* *

San Diego is fast becoming "Animal City, USA." If you like animals, believe me, you'll love San Diego. The huge zoo here is generally conceded to be the finest in the world. The Zoo's auxiliary, the "Wild Animal Park" (25 miles from here), is both a showplace and scientific breeding area for all kinds of animals, most of them roaming uncaged through the hundreds of acres of this huge African-like park setting. Then last week San Diego's Sea World announced that it was adding a 7-million gallon tank for its killer whale exhibit. This would make San Diego's Sea World "the largest marine animal habitat in the world."

Speaking of animals, on my early morning walks I almost always see a collection of wild animals such as possums, owls, pelicans, you name it--and all right here in La Jolla. But last week was a first for Animal City, USA. In the middle of the Padre-Pittsburgh baseball game a skunk walked out on the field, and game was held up seven minutes while the smelly little fellow was chased off the field. A few mean-spirited observers claimed that the skunk was symbolic of the capabilities of San Diego's baseball team.

* *

The US is probably the only nation in the world to leave its border literally unguarded and unprotected. If Libyan or Syrian terrorists want to enter the US, all they have to do is come down to Tijuana and ask the local Mexicans how they do it. Here in San Diego county INS agents in April made 71,910 arrests for illegal entry, a one-month record and up 68% from April 1985. And remember, that figure is just for illegals actually apprehended -- most illegals are not caught. The accompanying paragraph is from an article in last week's San Diego Union:

I visited the hell at our doorstep with Border Patrol officers during a recent afternoon and night of the full moon. Our first stop in the gathering dusk was on a small knoll just north of the so-called soccer field, where multitudes of aliens were gathered awaiting darkness. It was a bizarre, unbelievable scene: A confrontation between a corporal's guard of border patrolmen and an immense army poised to invade this country. Neither side would move until after sunset. There has never been anything like this in the entire history of the United States. It is incredible that this powerful nation passively tolerates such a gross violation of its sovereignty.

* *

In the last Letter I mentioned the new book by Peter Brimelow (he's on the Barron's staff) entitled "The Wall Street Gurus" (Random House, $19.95). This is a fine book, and I understand Brimelow did a year of research before writing it. I can believe it. This is about the only book I've seen that recounts some of the history of the investment letter writing business.

Since I have spent the last three decades in this crazy business, I was particularly interested in the book. Brimelow mentions many old friends of mine from Garfield Drew to George Schaefer, from Granville to Schultz. Unhappily, the book centers to a large extent around so-called performance, and for performance Brimelow relies on Mr. Hulbert. As subscribers must know, I believe the Hulbert performance ratings are an exercise in nonsense, but the Hulbert thing seems to have caught on. On this basis, I suppose that somewhere ahead some advisor will put out a report that will simply list "10 stocks to buy now for ZOWIE profits" and that will be the sum total of his report. My criterion for a successful report is this: When my subscriber puts down one of my Letters, does he know any more than when he picked it up? If he doesn't, the Letter was a failure and a waste of time.

Despite my objections, "The Wall Street Gurus" is a fine book, and it is one that has been carefully researched and well-written (it also contains many humorous observations and anecdotes). I recommend this book highly.

* *

Tax Bill: After studying the new Senate Finance Committee tax bill and after talking to various people about the bill, I've come to the following conclusions. (1) The bill is deflationary. It will bring about a drop in capital spending and will create a near-depression in the commercial real estate business. (2) The bill does just what is not needed in the US in that it militates toward more spending and less saving. Savings are killed by eliminating capital gains, by eliminating tax shelters and by eliminating the tax deductions on IRAs. (3) Actually the bill is a tax-transfer vehicle which will transfer income from the middle class (the big savers) and give it to the poor and some of the very rich. (4) As the bill stands, the biggest shaft will be given to those who have invested heavily in tax shelters (although these may be given partial grandfather clauses in the final bill). Conversely, as the bill stands, the biggest beneficiaries will be muni bond holders-- who will be relatively untouched. The man with big tax-free muni income will be literally unaffected by the Senate bill. Munis remain the ONLY WAY to get around the tax system.

And oh yes, incredibly I have heard very little criticism of the new tax proposals except from the commercial real estate lobby. The

Senate version still has to face a compromise with the House. I personally don't think the House will ask for too many compromises. Reagan, who wants to establish his name in history, is 100% for the bill. I think there is an excellent chance that it is going to pass.

Final thought: consider this-- most of the big cities have literally been built through tax shelter real estate. Construction projects usually lose money while they are being built, but up to now builders and investors have been able to use the losses to offset their other income, and this lowered their tax bill. But the new Senate bill says that these losses cannot be applied against general income. This will mean a "stop work" for big builders who will not want to build under these conditions. It's going to be an interesting situation in real estate.

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The New York Times (May 12) published a major piece on water. The gist of the article was that we are fast approaching the time when water is going to be deregulated, at which time it will sell on a supply-demand basis. I agree and have been telling subscribers that water is fated to be the leading scarce commodity of the late-1980s and 1990s. For this reason I have recommended and continue to recommend the water stocks. AWK, PSC and UWR on the Big Board plus o-t-c stocks CWTR, CONW, WTR, SWTR. Buy 'em (if you haven't yet) and hold 'em. The water story has not been told yet. The public knows little or nothing about the coming water crisis.

* *

I have asked subscribers to avoid insured muni bonds. As I have stated so often, if a bond needs insurance, I don't want it. Every bond should be able to stand on its own--without insurance. Two bond insuring outfits have recently been down-graded by S&P. The first was Industrial Indemnity Co. and now USF&G, both down-graded from AAA to AA. Naturally, the bonds that are insured by these companies are also down-graded in ratings.

* *

If you've noticed that these Letters have become longer and more verbose, you can blame it on (or thank) my new Macintosh computer. The Mac gets about 25% MORE words on a page, compared with my previous machine (an IBM typewriter). So put it this way: those who like my writing will be getting a bigger bargain in terms of Russelliana. Those who don't want me getting too wordy will have to do some skipping and scanning.

* *

By the way, I am leaving on May 17 to make my annual pilgrimage to NYC, the place where I grew up and spent the first 35 years of my life (actually, I should subtract 3.5 years for time out in the old Army Air Force -- today it's the US Air Force). We'll be in Gotham (how come they don't call it "Fun City" anymore?) for about six days. Faye and I will be visiting old friends, looking at art, eating good food, wandering around museums and visiting my old neighborhoods (my family always lived in mid-town Manhattan). By the way, did you hear that they are going to rebuild Madison Square Garden for the umpteenth time? The cost of the new Garden-- get this: 1 billion dollars!

So if I'm squeezed for time, the NEXT Letter may be a bit shorter, maybe four pages instead of six-- maybe not. C'mon, gimme a break. I haven't taken a full seven-day vacation since 1957. But don't grieve for me, I love this business.

* *

Is the whole world going to resemble Calcutta by 2025? According to the United Nations World Population report, the world's population will have risen from the current 2 billion to a total of 5.1 billion by 2025! The UN also sees the rise of "super cities" with populations of 16 million or more. Most of these cities will be in the developing world with the monsters being Mexico City, Sao Paulo, Tokyo-Yokohama, Calcutta, and Greater Bombay. NYC-North New Jersey will be the world's sixth largest "agglomeration."

The New York Times, a dyed-in-the-wool Democratic newspaper (and hardly an admirer of Reagan's), surprised (even shocked) me with their glowing front-page piece (May 7) on the Tokyo conference. According to the piece, our "cowboy president" has turned into a world statesman. Coming from the Times, that's high praise indeed. A few excerpts from the piece are included here:

> **President Reagan is riding high here. True, he carries the scars of earlier defeats and still loses a round or two, as he did here. He also has learned to compromise.**
>
> **But he has sold other countries the spirit of Reaganomics, if not all the substance. Every one of the governments represented here is busily deregulating its markets, encouraging growth of private business, talking of overhauling its tax system, shrinking the welfare state and wishing aloud that it could create jobs the way the United States does.**
>
> **Much of this is true not only of the two remaining Socialists here, François Mitterrand of France and Bettino Craxi of Italy, but true as well of the world's most populous countries, China and India.**
>
> **Not surprisingly, Mr. Reagan's entourage testifies to the new deference accorded him. "They look in his eyes and see an economy that has been growing for four years," said one of the American officials attending the President here. "They look at him and see a 68 percent popularity rating, which none of them have got."**

* *

Writing for the Washington Post, David Broder notes that Ronald Reagan has brought in the new Era of the Geezer. Forget about flaming youth, the old guys and gals are doing it now! Think about it: Jack Nicklaus wins his sixth Masters' golf tournament at age 46, Bill Shoemaker wins his fourth Kentucky Derby at age 54, Vladimir Horowitz at age 81 wows 'em in Russia, Phil Niekro at age 47 still giving the batters his old knuckle ball. Then there's Hume Cronyn at 74 and Jessica Tandy at 76 knocking them dead on Broadway with their new play, "The Petition." There are former governors Jim Rhodes, 76, and Terry Sanford, 68, winning nominations for governor in Ohio and North Carolina. The new cry is "it ain't over till it's over," and the oldies are proving it here in 1986.

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Despite the slumping dollar and the climbing yen, the Japanese trade balance with the US incredibly keeps climbing. Japan's trade surplus with the US this year looks to hit a whopping $60 billion vs. $50 billion last year. Right now the annualized domestic sales for cars in the US appears to be about 7.8 million. But imported car sales are running at an annualized rate of 3.3 million, up 26% from last year! Meanwhile, US car dealers are staggering under one of the worst unsold car gluts ever, with Chrysler and GM both with 50% too many cars for this time of the year (only Ford has its inventory under control). AMC's overage is twice normal. Despite everything that has been done, buyers in the US want foreign cars--at increasingly higher prices.

CONSPIRACY: I have been asked repeatedly whether I feel that one or more conspiracies are in operation in the US. Here is my answer.

Obviously, there are always minor conspiracies going on. Today's major conspiracy is in the open (therefore, it should not be considered a true conspiracy), and that is the Communist intention to "bury us." I have stated repeatedly that I believe the Communists (Russia) are committed to a policy of world domination. But they have never made a secret of their intent. The only secret is why so many Americans refuse to believe it.

But there are those who believe that we face vast and insidious conspiracies here in the US and among the conspirators they include the Senate Foreign Relations Committee and the "Tri-lateral" Commission. I honestly don't think this is true. In other words, I don't think our bankers or the World Bank or various heads of industry or the Rockefellers or Congress are part of a conspiracy to turn the US over to "world interests" or to the Communists or anyone else.

However, I do believe that an awful lot of stupidity goes on. I think the big bank loans to the less-developed nations were idiotic. I think that American oil and synthetic fuel policies have been stupid. I think that many acts by our politicians were so short-sighted or moronic that they seem to verge on treason. The problem is that politicians are not always brilliant, and politicians tend to vote their own self-interest (meaning they vote for what they feel will get them elected).

Recently I received a circular that states, "The 445 People Responsible for All of America's Woes." The 445 people in question are 435 congressmen, the President and the Supreme Court. And in one sense, the circular is correct. Congressmen make the laws (not the President), and congressmen voted in tax laws and the spending programs and they are the ones who have laid the groundwork for the deficits. But it is you and I who have voted in the congressmen, and it is you and I who can vote them out. So who is to blame for America's problems, the people or the congressmen? It's a good question, and my own feeling is that democracy and the viability of the US is totally dependent on an INFORMED electorate. The fact is that our electorate is not informed.

Philosophically, a democracy is a system that allows the people to make their own mistakes (as opposed to say fascism in which the dictator makes all the decisions, right or wrong). But in today's world, major mistakes may mean the death of the system as we know it. Why do I say this? First, because our entire financial system is now "on the line." The nation has never had debts comparable to today's deficits. Nor has it ever had such adverse balance-of-payments. Nor has the US manufacturing or technical lead ever been so threatened. And finally, the US has never faced another super-power with the expressed intention and the potential military power to dominate us.

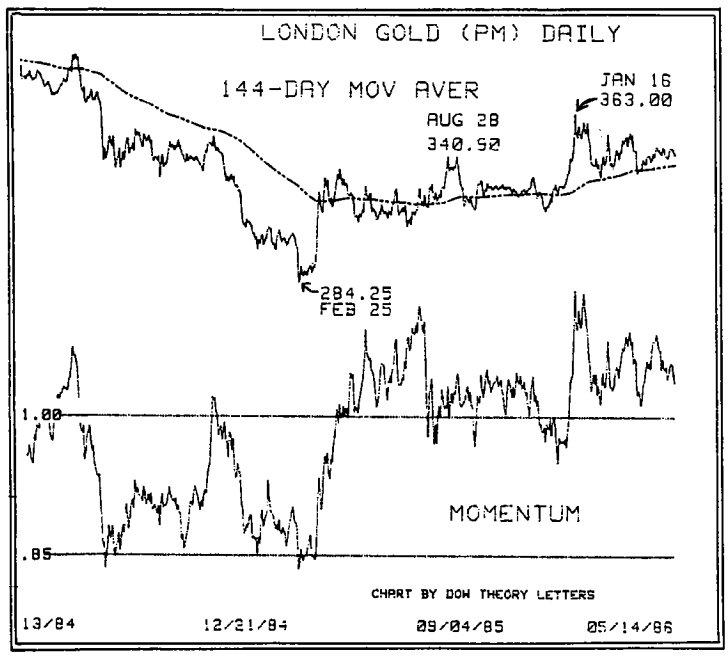
In other words, we have made major, even catastrophic, mistakes in the past and we survived them. I am not sure that we can make that kind of major mistake in the future. It's a far different world today than it was in 1914 or 1942 or even in 1960.

STOCKMAN: You may think David Stockman is an elitist whimp who's double-crossing his ex-boss, but I'll vouch for one thing--he's smart as a whip, and he understands US finances as few other men do. Furthermore, Stockman is now free to say anything he wants. And these days David is doing a lot of talking.

Stockman is now saying that a tax increase is "imperative." He advocates (as I have for years) a national sales tax, and Stockman thinks the states should collect that tax and keep a portion of it. Stockman states that the federal budget deficit is now running at the rate of $200 to $210 billion. He says that you have to take the early budget estimates with a grain of salt because the figures "always turn out to be worse."

Furthermore, Stockman says that the only reason there may be any improvement in the budget deficit is because defense spending is being cut. Says Stockman, "The defense buildup is over...They've lowered the boom. On a de facto basis, that is how this deficit has been contained....When all else failed, Congress just dropped the defense buildup...:after it had started the thing in motion."

Finally, Stockman is leery of the new tax bill. He's afraid that in the long run it could have unpredictable consequences. Of course, two of those consequnces could be a shortfall in tax receipts to the Treasury and a sock in the jaw to US business. Reading the above, is it any wonder that the bonds are correcting?



GOLD: It sounds almost impossible, but a five-year low for the gold/common stock ratio (i.e., gold divided by the NYSE Composite) occurred last December 16 at a ratio figure of 261. Now, five months later, the ratio is 253, only slighter lower. What is this telling us? It tells us that gold has very nearly kept up with common stocks over the last five months. Sounds weird? Maybe, but those are the statistics.

Now turn to my gold chart. Here's the whole story in one little picture. Right now, despite little or no inflation, despite a rotten commodity market, gold is holding above its 144-day (exponential) moving average. The average is now at 337 and slowly rising. Moreover, the gold momentum index is holding above 1.00 (meaning that gold is above its level of 89 days ago). So both of these gauges for gold are still positive.

"Why is gold still in a bullish mode?" You want my guess? My guess is that there are certain people out there, central bankers, millionaires, Arab princes, Japanese businessmen, who just don't trust paper--any kind of paper. So these people keep buying gold. Are they nuts? Are they wrong? I only know that I haven't sold any of my own Maple Leafs or Krugerrands or Pandas yet--and I'm not even an Arab prince (far from it!). But I do like *diversification*, and I am *patient*. So I hold my coins (no gold stocks--just the coins).

LATE NOTES: On May 15 the D-J Transports broke decisively below its April 7 low of 778.83. Thus, from the standpoint of the bulls we have a downside non-confirmation. But from the standpoint of the pessimists, we have one-half of a potential bearish signal. It remains to be seen whether the Dow can hold above 1735.51. If the Dow holds, that will be a big bullish plus for the market. BUT if the Dow confirms the Transports by violating 1735.51 (particularly on heavy volume), then we could easily test the long-term moving averages of the Dow down in the 1500 to 1600 area.

Late thoughts on the new tax bill (which looks increasingly as though it's going to pass in some form). A friend who is a tax expert calls this the *"cash and carry bill."* The bill is great for those with lots of cash and little debt, but very rough on those who borrow to keep up their standard of living (and I'm referring to the middle class and the yuppies). Unfortunately for the economy, it's the borrowers who are the big spenders. It is the poor who will do BEST under the new bill-- and it is also the poor who have the VOTES.

NEXT MAILING: June 4